

OUTSOURCING BENEFIT ADMINISTRATION

EXECUTIVE SUMMARY

Outsourcing of benefits administration is a growing trend. Depending on an organization's culture, the decision to outsource can be daunting. It can be less intimidating if the organization realizes that outsourcing offloads performance responsibilities and technology risk onto the vendor, while freeing staff to focus on core competencies.

Organizations generally pursue outsourcing for one or more of the following reasons:

- To provide additional services
- To improve services
- To reduce costs.

Many organizations can benefit from outsourcing because they gain the vendor's expertise, dedicated focus and ability to spread the capital cost of advanced and continuing technological improvements across many customers. Organizations usually choose to outsource in hopes of receiving more and better service for the same or less cost.

Terminology

Because Act 88 specifically authorizes the Hawaii Employer-Union Health Benefits Trust Fund (EUTF) to hire a third-party administrator (TPA), Request for Proposals (RFP) 03-02 is referred to as the "TPA" RFP. While the Contractor sought under the RFP would be a third-party and would provide administrative services, the term TPA is typically used by benefit professionals to refer to claim administrators.

Most benefit professionals would refer to this proposal as an "outsourcing" proposal, which is the terminology used in this white paper. "Privatization" would also be an appropriate term.

"Insourcing" is often used as the opposite of outsourcing. "Service providers" is often the term used to describe outsourcing vendors.

Outsourcing in Other States

Garner Consulting researched the question of whether any states have outsourced benefit administration. We could only find one state that has outsourced benefit administration: Florida. In fact, Florida outsourced all personnel administration, including benefits. Florida decided to outsource in 2002 based on a determination that outsourcing would both reduce costs and improve service. One of the duties Florida is not outsourcing is communications with employees. Because of the large scope of the outsourcing, it is being phased in, with certain functions scheduled to be outsourced sooner than others.

Outsourcing Trends

According to IDC, an outsourcing research organization, human resource outsourcing is growing at the rate of 30 percent per year and is a \$35 billion industry.

Functions Not Outsourced

Benefits administration functions are strategic and transactional. It is important to note that a number of functions cannot be outsourced. Some of these duties reside with the Board and the Board would need staff to assist it in performing these duties.

In general, the Board and the staff would need to focus on strategic functions while the outsourcing vendor would handle transactions. The EUTF staff can assist the Board with issues related to plan design, financing and vendor management, including managing the carriers and the service provider. While we expect any outsourcing vendor would assist the EUTF with compliance and communications with participants, these responsibilities will always ultimately belong to the EUTF.

EUTF Staff Positions with Outsourcing

While the cost of an outsourcing vendor's services can be partially offset by reducing the EUTF staff, it is important to note that the EUTF staff would not be eliminated.

There would continue to be a need for an Administrator/CEO. As long as there is any staff, someone would need to be in charge.

There would also continue to be a need for a Financial Management Officer. This position could evolve over time to include responsibility for managing the outsourcing vendor, but even without that duty, the EUTF would need someone to coordinate financial transactions with the vendor and to monitor financial transactions.

As indicated above, the EUTF will always have ultimate responsibility for compliance and communications with employees. Therefore, the position of Communication and Regulatory Specialist would need to remain.

The EUTF's Information Systems Analyst would be very involved in any transition to an outsourcing vendor. Because there would be a need for coordination with a number of payroll and human resources information systems with the various state agencies and the counties, we believe there would be an ongoing need for an IT Manager.

All of these individuals would need staff support. Therefore there would continue to be a need for a Secretary.

It is possible that the Assistant Administrator position could be eliminated at some point in the future. We would not recommend eliminating this position right away. We expect that this position would be needed after the transition to coordinate a multitude of issues that would arise with regard to how the EUTF wishes the new vendor to handle certain situations.

Once any vendor is in place and all transition issues have been resolved, it may become apparent that one or two positions could be eliminated. These would most likely be the Assistant Administrator and Information Systems Analyst positions. Until everything is running

smoothly, we would not recommend cutting staff. It is crucial that the EUTF not just abdicate its responsibilities by "dumping" them on an outsourcing vendor. There should be a partnership between the EUTF and any vendor and that would require staff to create the proper environment.

Positions That Could Be Eliminated

Most of the positions that could be eliminated are those that were previously Health Fund positions. We believe that all of the positions that came from the Health Fund to the EUTF as of July 1, 2003 could be eliminated if the EUTF chooses to outsource. As we understand it, incumbents in these positions would be entitled to other jobs with the State.

The new customer service positions could also be eliminated if the EUTF chooses to outsource. These incumbents would not be entitled to other jobs with the State.

It is possible that an outsourcing vendor would offer jobs to most or all of the incumbents. Some incumbents who have guarantees of other jobs with the State may prefer to stay in government service for a variety of reasons.

Technology Risk

One of the major reasons organizations outsource benefit administration is to offload technology risk. IT systems are very expensive and new technological advances can make a relatively new system obsolete. By contracting with an outsourcing vendor, an organization can shift the risk of high IT costs to the service provider.

Outsourcing vendors are in a better position to absorb the risk of changes in technology for two primary reasons:

- ▶ First, outsourcing vendors can spread the IT costs over many more employees and organizations than can a single organization, even one as large as the EUTF.
- ▶ Second, outsourcing vendors must maintain the latest technology in order to remain competitive. No such imperative exists for the EUTF, where high IT costs would be likely to lead it to maintain an outdated system.

If the EUTF wishes to shift the technology risk and to have a vendor that is committed to maintaining state-of-the-art systems, it would be important to choose a vendor with very strong financials. Most of the successful outsourcing organizations are large companies.

Control

Control is a major issue for organizations to address when considering outsourcing. Does the EUTF Board want to "own" the benefits administration process? If so, outsourcing is probably not a good choice.

Insourcing may be the best direction if the Trustees do not like the thought of a service provider controlling the processes for your benefits administration. Similarly, insourcing may be best if the Trustees do not like the idea of the people who manage those processes being employees of an outside service provider.

However, outsourcing may be a good choice if the Trustees like the idea that the continuous improvement of your benefits administration is the responsibility of a provider whose core competency is human capital management. Outsourcing may also be appropriate if the Trustees would be relieved by knowing that the service provider has assumed the challenge of recruiting, hiring, training, and retaining the specialized human capital management talent necessary to do the job. Just as outsourcing can offload technology risk, it can also relieve an organization of the need to stay at the cutting edge of training and processes.

Flexibility

In all probability, a TPA could act more quickly than the EUTF in responding to sudden needs. For example, a temporary need for additional resources during open enrollment could be met without having to go through a cumbersome approval process. The TPA could accomplish this by reallocating the workload of its current staff or by hiring additional staff. While private companies also have their approval procedures, they are often more nimble than those of a governmental agency.

Size and Capabilities

As mentioned above, the technology risk can best be shifted to a large, financially secure organization. Unfortunately, none of the leaders in benefit outsourcing have the local presence in the Islands that combines the latest technology and processes with knowledge of the local culture. Therefore, the Trustees may be forced to choose between one of the leading organizations in the field that would be attempting to learn the local environment, or a smaller, local firm that has the customer service capability, but not the latest technology.

The Trustees should begin thinking about the relative merits of each approach.

World-Class Delivery Processes and Service

An increasing number of organizations that place a high value on benefit programs outsource to achieve world-class delivery processes and service. They're adamant about getting the fundamentals right and, thus, count on their outsourcing partner to increase operational efficiency, improve data accuracy and consistency, and provide high-quality service to end users of benefit information and processes.

It is possible to provide world-class service while insourcing, but it requires a major commitment of resources.

Costs

Organizations often outsource to keep operating costs under control. Since outsourcing can improve benefit administration process efficiency and service delivery, transaction costs can go down. As for fixed costs, outsourcing insulates organizations from the continual capital investments necessary to maintain leading systems and service infrastructure.

Outsourcing's potential to reduce costs certainly captures attention. The challenge is that few organizations have a solid handle on the complete range of their pre-outsourcing hard- and soft-dollar HR costs.

For example, outsourcing can provide a higher level of service than might be reasonably expected from an internal department. Faster response times and convenient access to benefit data can increase participant satisfaction, as can the ability for employees and retirees to use interactive voice response (IVR) or web access to complete certain transactions themselves.

Another and perhaps more direct example is that higher levels of compliance can minimize liability costs.

As part of the proposal evaluation process, Garner Consulting will assist the EUTF in quantifying the current costs and the costs required to provide comparable levels of service as well as identifying the cost of adding certain enhancements to current internal capabilities. Better control of the tangible and intangible costs, along with the value added from process and service improvements, makes outsourcing the right choice for many companies.

Conclusion

The Board must address several issues in deciding whether or not to outsource:

- ▶ Both this white paper and the RFP state reasons for outsourcing. Each Board member must be able to articulate for themselves the objectives of outsourcing and the group must agree on those objectives and their relative priority.
- ▶ How much control does the EUTF want to maintain over future cost increases? For example, the Board must consider the possibility that at some future contract renewal date, the costs proposed are much higher than expected and then will need to weigh the alternatives of accepting those increased costs or incurring the cost to take the administration in-house or change vendors.
- ▶ How much control does the EUTF want to maintain over benefit administration processes?
- ▶ How important is the ability to respond quickly to changing circumstances?
- ▶ How important is the having the latest technology versus already being familiar with the local environment?
- ▶ During the proposal evaluation process differing levels of service between service providers and the insourcing alternative should become apparent. Once the Board understands the differences and their associated costs, the Board will need to determine which services it wants and can afford.

Regardless of the decision the Board ultimately makes, if these issues have been thoroughly considered, then the decision will be a good one.